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**STATE AID, THE GROWTH OF LOW-COST CARRIERS IN  
THE EUROPEAN UNION, AND THE IMPACT OF THE  
2005 GUIDELINES ON FINANCING OF AIRPORTS AND  
START-UP AID TO AIRLINES DEPARTING  
FROM REGIONAL AIRPORTS**

RYAN GRIFFIN\*

I. INTRODUCTION

THE DEVELOPMENT of an efficient, low-cost transportation network is central to the European Community's stated goal of establishing a common market "to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increase in stability, an accelerated raising of the standard of living and closer relations between the States belonging to it."<sup>1</sup> In the last decade, Europe's air transportation sector has undergone radical changes. Increasing liberalization and the expansion of the European Union ("EU") has increased domestic competition, accelerated the addition of new routes, and lowered ticket prices for consumers.

European airlines have historically been heavily subsidized and, in many cases, owned by national governments.<sup>2</sup> Because of the large number of people employed by airlines, the social consequences of staff reductions, and state involvement in airlines, there was significant resistance to liberalization of air transportation in Europe.<sup>3</sup> Air carriers were often seen as a tool

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<sup>1</sup> Treaty Establishing the European Economic Community art. 2, Mar. 25, 1957, 298 U.N.T.S. 11 [hereinafter Treaty of Rome].

<sup>2</sup> Paul Stephen Dempsey, *Competition in the Air: European Union Regulation of Commercial Aviation*, 66 J. AIR L. & COM. 979, 983 (2001) [hereinafter *Competition in the Air*].

<sup>3</sup> John Balfour, *State Aid to Airlines—A Question of Law or Politics*, 15 Y.B. EUR. L. 157, 168 (1995).

to promote public policy objectives.<sup>4</sup> These objectives included increasing tourism, reducing unemployment, enhancing national security, and promoting domestic aircraft manufacturing.<sup>5</sup> By the 1980s, the European Community began to move toward liberalization,<sup>6</sup> and in 1994 the European Community's "third package" of liberalization rules significantly changed the structure of Europe's airline industry.<sup>7</sup> In particular, the third package addressed state aid to airlines and the danger state aid posed to a liberalized market.<sup>8</sup>

In the midst of increasing liberalization, low-cost air carriers like Ryanair and easyJet—modeling themselves on American budget airlines like Southwest and AirTran—took advantage of Europe's new, increasingly competitive air transport market.<sup>9</sup> In the past decade, the number of low-cost, no-frills carriers has grown exponentially, and low-cost carriers now account for approximately 20% of the European Union's air transport market share.<sup>10</sup> While this number lags behind the low-cost market share in the United States, where approximately 30% of the domestic market share is controlled by low-cost carriers, trends in the United Kingdom indicate that low-cost carriers will continue to gain market share in mainland Europe.<sup>11</sup>

While concerns with state aid initially centered on subsidies, bailouts, and other aid given to flagship carriers by their corresponding states, one recent, high-profile state-aid decision, the

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<sup>4</sup> Paul Stephen Dempsey, *Turbulence in the "Open Skies": The Deregulation of International Air Transport*, 12 TRANSP. L.J. 305, 362-63 (1987).

<sup>5</sup> *Id.*

<sup>6</sup> *Competition in the Air*, *supra* note 2, at 983.

<sup>7</sup> Arthur Reed, *Liberalization After 2 Years: The European Airline Industry's March Toward the Open Skies Is Slowed by Recession, Falling Fares and State Aid*, AIR TRANSP. WORLD, Jan. 1995, at 45, 46.

<sup>8</sup> *Competition in the Air*, *supra* note 2, at 1124.

<sup>9</sup> *Turbulent Skies*, ECONOMIST, Jul. 10, 2004, at 68, available at [http://www.economist.com/business/displaystory.cfm?story\\_id=2897525](http://www.economist.com/business/displaystory.cfm?story_id=2897525).

<sup>10</sup> *Community Guidelines on Financing of Airports and Start-Up Aid to Airlines Departing from Regional Airports*, 2005 O.J. (C 312) 1, ¶ 16 [hereinafter 2005 Guidelines].

<sup>11</sup> The United Kingdom and the Netherlands were the standard bearers for liberalization in Europe, entering into a number of bilateral transport agreements with other nations in the 1980s. *Competition in the Air*, *supra* note 2, at 987. In 2003, low-cost carriers accounted for approximately forty percent of service touching the United Kingdom. The Directorate-General of Energy & Transport [DG TREN], DG TREN—ANALYSIS OF THE EUROPEAN AIR TRANSPORT INDUSTRY 2003, FINAL REPORT 103 (2005), available at [http://europa.eu.int/comm/transport/air/rules/doc/2003\\_annual\\_report\\_en.pdf](http://europa.eu.int/comm/transport/air/rules/doc/2003_annual_report_en.pdf) [hereinafter 2003 DG TREN Report].

Ryanair decision, involved state aid to low-cost carriers.<sup>12</sup> The circumstances surrounding the Ryanair decision reflect the business model of low-cost carriers, and the outcome reveals a conflict between two of the European Union's policies: raising the standard of living and achieving an internal market free from distortion. In response to the Ryanair decision, the European Commission ("Commission") released guidelines addressing aid granted to publicly owned regional airports and start-up aid given to airlines departing from those airports.<sup>13</sup>

This paper examines the European Community and the European Union's movement towards air transport liberalization and the growth of low-cost air carriers in Europe. In particular, this paper will focus on the evolution of the Commission's stance on state aid to airlines, the effect of low-cost carriers on the way the Commission thinks about state aid, and the impact that the new guidelines on state aid will likely have on the growth of low-cost carriers and secondary airports in Europe.

This paper will begin with a brief discussion of low-cost carriers, focusing on their business model and recent success. Next I will discuss the Commission's 1994 paper on state aid in the aviation sector and the implication of those guidelines on new entrants to the air transport market. The paper will then segway into recent developments in state aid as it relates to air transport, focusing on the Commission's 2004 decision relating to benefits given to Ryanair by the Walloon Region and Brussels South Charleroi Airport. Finally, I will discuss the Commission's 2005 guidelines on state aid to regional airports and start-up aid to air carriers, and how these guidelines might impact low-cost carriers.

## II. LOW-COST CARRIERS

In 1971, Herb Kelleher decided to launch "a different kind of airline."<sup>14</sup> Thirty-five years later, his airline, Southwest Airlines, is the model for low-cost carriers. Since the deregulation of the United States air transport market in 1976 and the European air transport market in 1994, low-cost carriers, led by Southwest,

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<sup>12</sup> Commission Decision 2004/393/EC, *Commission Decision of 12 February 2004 Concerning Advantages Granted by the Walloon Region and Brussels South Charleroi Airport to the Airline Ryanair in Connection with Its Establishment at Charleroi*, 2004 O.J. (L 137) 1, 1 (EU) [hereinafter *Ryanair Decision*].

<sup>13</sup> 2005 Guidelines, *supra* note 10, ¶ 19.

<sup>14</sup> Southwest.com, We Weren't Just Airborne Yesterday, <http://www.southwest.com/about-swa/airborne.html> (last visited Mar. 10, 2006).

have played a significant role in the increased efficiency of air carriers, expansion of air services, and lower costs to consumers.

#### A. THE LOW-COST BUSINESS MODEL

The business model employed by low-cost carriers has allowed them to take advantage of lower costs, keep downward pressure on airfare, and has forced legacy carriers to provide more consistent service. Low-cost carriers operate far more efficiently than legacy carriers. For instance, the United States' largest carrier, American Airlines, operates at a significant cost disadvantage to its low-cost competition. American's costs on domestic flights are 26.9% higher than Southwest and 62.5% higher than JetBlue.<sup>15</sup>

While there is no unified business model for low-cost carriers, two elements typify the low-cost business model: simple products and low operating costs. Low-cost carrier business practices include: a single passenger class, a single type of airplane, a simple fare scheme, unreserved seating, flights to secondary airports, point-to-point rather than hub and spoke networks, emphasis on direct ticket sales, and elimination of in-flight meals and other in-flight services.

Traditionally, low-cost carriers have relied on secondary airports to help keep operating costs low. Secondary airports have several advantages over large primary airports. First, secondary airports usually charge lower landing and service fees.<sup>16</sup> Airport fees are a significant portion of an airline's costs, so low-cost airlines typically fly into secondary airports to take advantage of the lower fees.<sup>17</sup> Low-cost carriers also utilize secondary airports to help increase efficiency. Secondary airports are typically less congested than primary airports, which allows low-cost carriers to reduce turnaround times and ultimately leads to higher daily aircraft utilization.<sup>18</sup>

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<sup>15</sup> Eric Torbenson, *Airline Industry Transforming*, BRADENTON HERALD, Nov. 6, 2005, at 4, available at 2005 WLNR 17935215.

<sup>16</sup> Triant Flouris & Thomas John Walker, *The Financial Performance of Low-Cost and Full-Service Airlines in Times of Crisis*, CAN. J. ADMIN. SCI., Mar. 1, 2005, at 3, 6, available at 2005 WLNR 8154827.

<sup>17</sup> *Id.*

<sup>18</sup> *Id.* (noting that "[l]egacy carriers have a turnaround time of more than 45 minutes whereas [low-cost carriers] frequently achieve the same task in less than 30 minutes").

Low-cost carriers often reduce operating costs by flying only one type of aircraft with one type of engine.<sup>19</sup> There are many advantages to operating one type of aircraft. First, the cost of training pilots, flight attendants, and maintenance crews is reduced because training on multiple types of aircraft is unnecessary.<sup>20</sup> Maintenance costs are minimized when there is only one type of plane in a fleet because spare parts can be ordered in large quantities.<sup>21</sup> A uniform fleet also leads to increased operating efficiency because pilots, crews and mechanics become more familiar with the aircraft.<sup>22</sup>

Low-cost carriers also keep costs low by offering a simple product. Elimination of first- and business-class tickets and reserved seating helps increase efficiency. Turnaround time is reduced at boarding because separate boarding for different classes of tickets is inapplicable, and because seats are not reserved, passengers are encouraged to hurry to obtain preferred seating.<sup>23</sup> By eliminating first- and business-classes, airplanes owned by low-cost carriers tend to have a higher seat density.<sup>24</sup> Finally, low-cost carriers lower their costs by eliminating complimentary services.<sup>25</sup> For example, Ryanair recently announced that it would dispense with its plane's window blinds, reclining seats, seat pockets, and headrest covers.<sup>26</sup>

Low-cost and legacy carriers also rely on different route structures. Legacy carriers typically rely on a hub-and-spoke network, while low-cost carriers tend to rely on a point-to-point route structure.<sup>27</sup> The hub-and-spoke network allows legacy carriers to take advantage of the high profit margins that result from long-distance flights by large aircraft filled near capacity.<sup>28</sup> Hubs are typically large airports located in densely populated areas.<sup>29</sup> Long distance flights route passengers through these hubs, and,

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<sup>19</sup> *Id.* at 7.

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> Flouris & Walker, *supra* note 16, at 7.

<sup>23</sup> *Id.* at 6-7.

<sup>24</sup> *Id.* at 7 (pointing out that "an easyJet Boeing 737-300 contains 149 seats, whereas legacy carriers have approximately 128 seats on average").

<sup>25</sup> *Id.*

<sup>26</sup> Cnn.com, Airline Explores Tolerance for Frill-Free Flying, <http://www.cnn.com/2004/TRAVEL/02/26/bi.no.frills.airlines.ap/index.html> (last visited Jan. 30, 2006).

<sup>27</sup> Flouris & Walker, *supra* note 16, at 7.

<sup>28</sup> *Id.* at 5-6.

<sup>29</sup> Kevin Bonsor, *How Airlines Work: Hubs and Spokes*, HOW STUFF WORKS, <http://travel.howstuffworks.com/airline3.htm> (last visited Mar. 22, 2006).

if necessary, “spoke” flights fly passengers to their final destinations.<sup>30</sup> The drawback of the hub-and-spoke network, from an efficiency standpoint, is that turnaround times can be substantially impacted by baggage handling delays and time spent waiting on passengers from connecting flights.<sup>31</sup> The point-to-point route structure allows low-cost airlines to further reduce their turnaround times by eliminating time spent waiting on passengers and luggage from delayed interlining flights.<sup>32</sup>

The business model for low-cost carriers is not uniform across the low-cost sector, but many low-cost carriers incorporate most, if not all, of the aforementioned practices into their business model. The cost-saving and efficiency benefits of these practices allow low-cost carriers to pass on savings to the consumer. Lower fares coupled with reliable services have helped fuel the demand for low-cost services and the recent boom in the low-cost air transport sector in Europe.

#### B. LOW-COST CARRIERS TODAY

Since the deregulation of the United States air transport market in 1976, particularly in the last decade, low-cost carriers have experienced rapid growth in terms of their air transport market share. Low-cost carriers have captured approximately thirty-five percent of the United States domestic market,<sup>33</sup> and Southwest Airlines, in terms of passenger numbers, is the fourth-largest airline in the United States.<sup>34</sup>

In recent years, low-cost carriers have fueled the growth of the United States domestic air market. Since the year 2000, the United States domestic air market has grown 8.2% in total departures, 6.4% in seats and 13.5% in available seat miles, and low-cost carriers now account for seventy-five percent of the growth at large hub airports.<sup>35</sup> Low-cost carriers have also had a significant impact on tangential markets as well. In 2003, American low-cost carriers had orders for 400 planes, while legacy carriers had only 150 planes on order.<sup>36</sup>

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<sup>30</sup> *Id.*

<sup>31</sup> Flouris & Walker, *supra* note 16, at 7.

<sup>32</sup> *Id.*

<sup>33</sup> Steven Lott & Aaron Taylor, *Arrivals: New Engine Driving U.S. Domestic Growth*, AVIATION DAILY, Feb. 2, 2005, at 3, available at 2005 WLNR 2811199.

<sup>34</sup> *Turbulent Skies*, *supra* note 9, at 68.

<sup>35</sup> Lott & Taylor, *supra* note 33, at 3.

<sup>36</sup> *Turbulent Skies*, *supra* note 9, at 68.

The growth of low-cost carriers in Europe in recent years has been drastic—twenty-five percent annually.<sup>37</sup> By 2003, low-cost carriers, which were virtually non-existent outside of the United Kingdom a decade ago, accounted for twenty percent of intra-EU scheduled capacity and forty percent of services touching the UK.<sup>38</sup> In 1996, thirteen city pairs were served by low-cost carriers.<sup>39</sup> By 2004, the number of city pairs served by low-cost carriers had increased to 639,<sup>40</sup> and between 1992 and 2000 the number of weekly seats on EU domestic routes increased from 2,891,000 to 4,084,000,<sup>41</sup> much of this attributable to low-cost carriers.

The rapid growth of low-cost carriers in Europe has led to a corresponding explosion of business at secondary, regional airports. Airports long ignored by flagship carriers are being colonized by low-cost carriers eager to take advantage of lower landing fees, faster turnaround times, and other benefits associated with smaller airports. The relationship between these airports, which are often publicly owned, and low-cost carriers forced the European Commission to re-examine its position on state aid to airlines.

### III. STATE AID

#### A. INTRODUCTION

The position historically taken by national governments in Europe—that airlines are a tool by which to advance certain social and economic policies<sup>42</sup>—substantially impeded the liberalization of Europe's air transport sector. Beginning in the mid-1980s, Europe took steps to liberalize its air transport industry, which culminated in 1993 with the adoption of a set of liberalization measures known as the third package.<sup>43</sup> The third pack-

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<sup>37</sup> INT'L CIVIL AVIATION ORG. [ICAO]), THE IMPACT OF LOW COST CARRIERS IN EUROPE 3 (2003), available at [http://www.icao.int/icao/en/atb/ecp/CaseStudies/Europe\\_LowCost\\_En.pdf](http://www.icao.int/icao/en/atb/ecp/CaseStudies/Europe_LowCost_En.pdf) [hereinafter IMPACT OF LOW COST CARRIERS].

<sup>38</sup> 2003 DG Tren Report, *supra* note 11, at 103.

<sup>39</sup> *Id.* at 107.

<sup>40</sup> *Id.*

<sup>41</sup> ICAO, EUROPEAN EXPERIENCE OF AIR TRANSPORT LIBERALIZATION 7 (2003), available at [http://www.icao.int/icao/en/atb/ecp/casestudies/europeliberalization\\_en.pdf](http://www.icao.int/icao/en/atb/ecp/casestudies/europeliberalization_en.pdf) [hereinafter EUROPEAN EXPERIENCE].

<sup>42</sup> *Competition in the Air*, *supra* note 2, at 984.

<sup>43</sup> The third package is comprised of three Council regulations. See generally Council Regulation 2407/92, Council Regulation of 23 July 1992 on Licensing of Air Carriers, 1992 O.J. (L 240) 1 (EC); Council Regulation 2408/92, Council Regulation of 23 July 1992 on Access for Community Air Carriers to Intra-Com-



age gave all air carriers having a Community license unrestricted, tariff-free access to the intra-Community market.<sup>44</sup> Since the adoption of the third package, many member states "have established public service obligations relating to frequency, service punctuality, availability of seats or preferential rates for certain categories of users within a clear legal framework."<sup>45</sup> In addition to the market liberalization of the third package, regulations by the Commission relating to the allocation of slots, ground handling services, and computerized reservation systems have spurred the liberalization of air transport in Europe.<sup>46</sup>

One of the more significant developments in the liberalization of Europe's air transport sector was the European Commission's decision to take action against member states that violated the state aid provisions in the Treaty Establishing the European Community by giving benefits to flagship carriers. Section 3 of the Treaty of Rome governs aid granted by states.<sup>47</sup> Article 92, section 1 provides:

Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.<sup>48</sup>

Arguably, without strict control of state aid, liberalization of the air transport industry would have been impossible. Before 1994, European states commonly provided their flagship carriers with operational aid, capital injections, exclusive rights, and other market distorting benefits. As one commentator put it, "the Commission's . . . policy for the grant of state aids has undoubtedly been a major factor in ensuring fair competition across the internal market."<sup>49</sup> In 1994, the Commission took up the sub-

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munity Air Routes, 1992 O.J. (L 240) 8 (EC); Council Regulation 2409/92, Council Regulation of 23 July 1992 on Fares and Rates for Air Services, 1992 O.J. (L 240) 15 (EC).

<sup>44</sup> 2005 Guidelines, *supra* note 10, ¶ 1.

<sup>45</sup> *Id.*

<sup>46</sup> *Id.* ¶ 2.

<sup>47</sup> Treaty of Rome, *supra* note 1, § 3.

<sup>48</sup> *Id.* art. 92(1).

<sup>49</sup> Daniel Calleja, Director-Designate Air Transp. Directorate, European Comm'n, Speech before the International Aviation Club: EU/US Aviation Policy (Nov. 16, 2004), available at <http://www.eurunion.org/News/speeches/2004/041116dc.htm>.

ject of state aid, noting that “in a situation of increased competition within the Community there is a clear need for a stricter application of State aid rules.”<sup>50</sup>

### 1. *The 1994 Guidelines*

The 1994 Guidelines were adopted primarily to address the massive amounts of aid granted by European nations to their flagship carriers. Although the scope of the 1994 Guidelines is significant and the guidelines are worthy of considerable study, this article will refrain from a full blown discussion of the guidelines and instead will highlight some of the more pertinent provisions with regard to their impact on low-cost carriers.

#### a. Introduction

The 1994 Guidelines focus on the application of Article 92 of the Treaty of Rome to the air transport sector.<sup>51</sup> The guidelines address aid granted by member states and include any activities accessory to air transport, direct subsidization, and indirect subsidization such as flight schools, duty-free shops, airport facilities, franchises, and airport charges.<sup>52</sup> The guidelines do not address subsidization of aircraft production.<sup>53</sup> The Commission’s approach in the 1994 Guidelines focused on the effect that benefits granted by a state to an airline might have on the market rather than the state’s aims in granting the aid. The guidelines note that “Article 92 of the Treaty does not distinguish between measures of State intervention by reference to their causes or aims, but defines them in relation to their effects.”<sup>54</sup> The Commission’s stance indicates that regardless of a State’s aim in granting aid, the effect that the aid has on internal markets will carry more weight than the social impact of the aid, in the eyes of the Commission, when determining whether such aid is prohibited by Article 92. The Commission points out that contributions or benefits are not “State aid within the meaning of Article 92 (1) . . . unless it confers a competitive advantage to specific undertakings to avoid having to bear costs which would normally have had to be met out of the undertakings’ own fi-

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<sup>50</sup> *Application of Articles 92 and 93 of the EC Treaty and Article 61 of the EEA Agreement to State Aids in the Aviation Sector*, 1994 O.J. (C 350) 5, ¶ 1 [hereinafter *1994 Guidelines*].

<sup>51</sup> See generally *id.*

<sup>52</sup> *Id.* ¶ 10.

<sup>53</sup> *Id.*

<sup>54</sup> *Id.* ¶ 13.

financial resources, and thereby prevent market forces from having their normal effect.”<sup>55</sup> The 1994 Guidelines address three types of state aid to airlines: subsidization of domestic routes, capital injections, and exclusive rights.<sup>56</sup>

b. Subsidization of Domestic Routes

The Commission took the position that, with respect to domestic routes, “[d]irect aids aimed at covering operating losses are, in general, not compatible with the common market and may not benefit from an exemption.”<sup>57</sup> However, the Commission recognized that without aid, air carriers might be forced to discontinue routes to disadvantaged areas, thus the Commission created two exceptions under which domestic routes could be directly subsidized.<sup>58</sup> The two exceptions to the ban on direct subsidization were for “public service obligations” and “aid of a social character.”<sup>59</sup>

In the case of a public service obligation imposed on a carrier, “a Member State may reimburse the carrier for any loss sustained in the process of operating the route.”<sup>60</sup> Routes that qualify as a public service obligation are defined as follows:

‘any obligation imposed upon an air carrier to take, in respect of any route which it is licensed to operate by a Member State, all necessary measures to ensure the provision of a service satisfying fixed standards of continuity, regularity, capacity and pricing, which standards the air carrier would not assume if it were solely considering its economic interest.’<sup>61</sup>

The Commission points out that a state may impose public service obligations “on scheduled air services to an airport serving peripheral or development regions in its territory or on a thin route to any regional airport in its territory provided that any such route is considered vital for economic development of the region in which the airport is located.”<sup>62</sup> To ensure that the market is not unduly distorted by public service aid, the Commission included several conditions that must be met for public service aid to be legal. “[T]he Commission considers that com-

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<sup>55</sup> *Id.*

<sup>56</sup> *Id.* ¶ 10.

<sup>57</sup> *Id.* ¶ 14.

<sup>58</sup> *Id.*

<sup>59</sup> *Id.*

<sup>60</sup> *Competition in the Air*, *supra* note 2, at 1127.

<sup>61</sup> 1994 Guidelines, *supra* note 50, ¶ 15.

<sup>62</sup> *Id.*

pensation for public service obligations does not involve aid provided that: the carrier has been correctly selected through a call for tender. . . and the maximum level of compensation does not exceed the amount of deficit as laid down in the bid. . . .”<sup>63</sup>

The second exception to direct subsidization of an air route, aid of a social character, derives from Article 92(2)(a) of the Treaty, which states, “aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned” is compatible with the common market.<sup>64</sup> “The aid must have a social character, i.e. it must, in principle, only cover specific categories of passengers travelling on a route (e.g. children, handicapped people, low income people).”<sup>65</sup> The guidelines direct that aid of a social character must be granted to all Community carriers providing such services.<sup>66</sup>

c. Indirect Subsidization and the Market Economy Investor Principal

The provisions of the 1994 Guidelines that have had the greatest impact on the structure of the European air transport market are those dealing with state-owned enterprises and aid received by those entities. Cash infusions and bailouts from states to their flagship carriers significantly distorted the market and kept low-cost carriers and new entrants from entering the European air transport market.<sup>67</sup> The Commission established a two-part test for determining whether impermissible aid is involved when a state provides benefits to an entity of which it is an owner.<sup>68</sup> The first part of the test is the application of the market economy investor principal, sometimes called the private investor test, which asks of whether a private investor would have made a similar investment or capital infusion.<sup>69</sup> If the Commission determines that the private investor test is not satisfied, the Commission will then “determine whether the aid is compatible with the common market under the derogations of

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<sup>63</sup> *Id.* ¶ 18.

<sup>64</sup> Treaty of Rome, *supra* note 1, art. 92(2)(a).

<sup>65</sup> 1994 Guidelines, *supra* note 50, ¶ 24.

<sup>66</sup> *Id.*

<sup>67</sup> *Id.* ¶ 14.

<sup>68</sup> *Id.* ¶ 25.

<sup>69</sup> *Id.*

Article 92(3) of the Treaty . . . .”<sup>70</sup> Article 92(3) of the Treaty provides as follows:

The following may be considered to be compatible with the common market:

- (a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment;
- (b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;
- (c) aid to facilitate the development of certain economic activities of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest. . . .
- (d) such other categories of aid as may be specified by decision of the Council acting by a qualified majority on a proposal from the Commission.<sup>71</sup>

In its discussion of capital infusion, the Commission describes three common types of aid and lists factors that it will take into account when deciding future cases.<sup>72</sup>

The first type of aid addressed is capital injection.<sup>73</sup> According to the 1994 Guidelines, “[c]apital injections do not involve State aid when the public holding in a company is to be increased, provided the capital injected is proportionated to the number of shares held by the authorities and goes together with the injection of capital by a private shareholder. . . .”<sup>74</sup> The Commission will “analyze the past, present and future commercial and financial situation of the company,” and the private investor test will be satisfied where a normal return can be expected within a reasonable time.<sup>75</sup>

The 1994 Guidelines next address loan financing.<sup>76</sup> To determine whether the private investor principal is satisfied, the Commission will “assess whether the loan is made on normal commercial terms and whether such loans would have been available from a commercial bank.”<sup>77</sup> Among the factors the Commission will consider are “the interest rate charged . . . [.]

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<sup>70</sup> *Id.*

<sup>71</sup> Treaty of Rome, *supra* note 1, art. 92(3).

<sup>72</sup> 1994 Guidelines, *supra* note 50, ¶ 26.

<sup>73</sup> *Id.* § IV.1.

<sup>74</sup> *Id.* ¶ 27.

<sup>75</sup> *Id.* ¶ 28.

<sup>76</sup> *Id.* § IV.2.

<sup>77</sup> *Id.* ¶ 32.

the security sought to cover the loan[,] . . . whether the security given is sufficient to repay the loan in full in the event of default[,] and the financial position of the company at the time the loan is made.”<sup>78</sup>

Finally, the Commission addresses loan guarantees.<sup>79</sup> The Commission will only accept loan guarantees that are contractually linked to specific conditions.<sup>80</sup> The amount of aid is “the difference between the rate which the borrower would pay in a free market and that actually obtained. . . .”<sup>81</sup> The guidelines go on to state that “[p]ublic enterprises whose legal status does not allow bankruptcy are in effect in receipt of permanent aid on all borrowings equivalent to a guarantee, when such status allows the enterprise in question to obtain credit on terms more favourable than would otherwise be available.”<sup>82</sup>

d. Exclusive Rights

The 1994 Guidelines also address the granting of exclusive rights for activities accessory to air transport. The Commission points out that an airline might realize significant financial benefit constituting state aid if a state or state-owned entity operating airport infrastructure were to grant an exclusive concession to an airline for less than market value.<sup>83</sup> Consistent with the position the Commission took with respect to indirect aid, the Commission’s position regarding exclusive aid was that “in general terms no aid is involved where the grantee is selected in circumstances that would be acceptable to a normal concession grantor operating under normal market economy condition[s].”<sup>84</sup>

e. Conceptual Impact of the 1994 Guidelines on Low-Cost Carriers and New Entrants

Conceptually, the impact of the Commission’s guidelines on state aid should have allowed the entry of new players into the European air transport market. With large national carriers no longer able to cover losses by way of the various subsidies and benefits pointed out in the 1994 Guidelines, market conditions

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<sup>78</sup> *Id.*

<sup>79</sup> *Id.* § IV.3.

<sup>80</sup> *Id.* ¶ 33.

<sup>81</sup> *Id.*

<sup>82</sup> *Id.* ¶ 34.

<sup>83</sup> *Id.* ¶ 44.

<sup>84</sup> *Id.* ¶ 45.

were ripe for the entry of the low-cost carrier. In particular, the elimination of direct operational subsidies on domestic routes promised to create a market for low-cost carriers.<sup>85</sup> Large national carriers could no longer count on external aid and would be forced to price according to their costs, creating a market for low-cost carriers. Additionally, the 1994 Guidelines' prerequisites to exceptions for public service aid and aid of a social character ensured that states could not circumvent the prohibition of subsidization for domestic routes and that this aid was available to all community carriers. The Commission's other limitations to state aid also seemed to level the playing field and help create a market for low-cost carriers.

The 1994 Guidelines' prohibition of cash infusions, whether in the form of capital injections, loan financing, or loan guarantees, was a key cog in the system that allowed low-cost carriers to enter into the intra-Community air transport market. These provisions, if followed, would force flagship carriers to tighten their purse strings and run according to market principals. No longer would flagship carriers be able to rely on national governments to remain solvent.

The 1994 Guidelines' provisions on exclusive rights for activities accessory to air transport also limited the free handouts a state could give its flagship carriers. By adopting a highest-bidder, market based approach to granting exclusive rights, national and flagship carriers were no longer guaranteed monopoly profits (aid) on services like duty-free shops and baggage handling. As a result, national carriers could no longer count on profits from these services to cover losses in other areas. The Commission's position on the concession of exclusive rights for activities accessory to air transport helped level the playing field for new entrants into the European transport market, particularly low-cost carriers.

When the 1994 Guidelines were released, many analysts suggested that the European air transport sector would undergo massive consolidation and that alliances of large carriers would come to dominate the market.<sup>86</sup> What the prognosticators did not suggest was the emergence of new entrants to the market and the growth of the low-cost carrier.

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<sup>85</sup> The low-cost model, which takes advantage of point-to-point travel, is well suited for short domestic flights.

<sup>86</sup> *Competition in the Air*, *supra* note 2, at 1151-52.

## 2. *The Impact of Liberalization and Strict Control of State Aid*

Since the adoption of the third package and the 1994 Guidelines, the European airline sector has changed considerably. Although there is no way to be sure that the third package and the 1994 Guidelines are the root cause of the last decade's changes in the air transport industry, the growth and the changing face of the airline industry suggest that the third package and strict limitations on state aid have played a substantial role in the evolution of the European air transport industry in the past decade.

Consumers have clearly benefited since the Commission adopted the third package and 1994 Guidelines. Benefits to the consumer include increased competition resulting in a greater number of carriers from which to choose, more destinations, greater flight frequency, and increased diversity of fares.<sup>87</sup> Although business-class and normal economy-class fares have increased by approximately forty-five and fourteen percent, respectively, since the early nineties, promotional fares have decreased by fifteen percent, which amounts to approximately thirty percent when accounting for inflation, between 1992 and 2003.<sup>88</sup> While there is no comprehensive collection of data showing the proportion of tickets bought in the various fare classes, increased availability of promotional fares offered by low-cost carriers coupled with the decrease in promotional fares bodes well for consumers.

From a purely economic point of view, it is hard to argue that the liberalization of the air transport industry has had a negative impact on Europe. While there are a number of collateral effects of liberalization, including increased congestion at airports, environmental issues, noise pollution, and increased volatility in the air transport market, it appears that the impact of liberalization has been largely positive.

## B. A NEW PARADIGM IN STATE AID

### 1. *Low-Cost Airlines and Regional Development*

The rapid growth of Europe's low-cost air transport sector has led to increasing utilization of secondary and regional airports. Regional authorities have taken notice of the impact that the

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<sup>87</sup> IMPACT OF LOW COST CARRIERS, *supra* note 37, ¶ 6.1.

<sup>88</sup> EUROPEAN EXPERIENCE, *supra* note 41, ¶ 6.5.1.



arrival of a low-cost carrier can have on a local economy. A recent opinion by the Committee of the Regions stated:

The continued development of [a network of services that provide point-to-point inter-regional air connections] has a clear and undisputed regional dimension; it facilitates region-to-region connection; supports citizens' mobility, encourages economic development and employment growth, promotes tourism, aids the regeneration of peripheral and less-developed regions in particular and thereby has a positive impact on economic, social and territorial cohesion in Europe.<sup>89</sup>

The Commission has recognized the benefits to the regions as well, noting that air transport has made "a significant contribution to economic and social cohesion and to balanced development in the regions."<sup>90</sup> Low-cost carriers also realize the economic impact their arrival can have on a region, and carriers often demand reduced landing and ground handling fees, assistance with marketing new routes, and other benefits in exchange for the promise to open new routes at an airport.<sup>91</sup> Secondary airports eager to attract new scheduled routes often oblige, promising reduced fees, faster turnaround times, and a host of other benefits.<sup>92</sup>

While competition and regional development should be encouraged, state aid issues may arise when state-owned regional airports offer incentives to low-cost carriers in exchange for the opening of new routes at the airport offering aid. A deal fraught with incentives between Ireland's Ryanair and Brussels South Charleroi Airport recently brought these issues to the center of Europe's state aid debate.<sup>93</sup> The ensuing legal battle forced the European Commission to address the issue, and in 2005, the Commission released guidelines on the financing of airports and start-up aid to airlines departing from regional airports.<sup>94</sup>

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<sup>89</sup> *Own-Initiative Opinion of the Committee of the Regions on Low-Cost Airlines and Territorial Development*, 2004 O.J. (C 318) 7, 8.

<sup>90</sup> *2005 Guidelines*, *supra* note 10, ¶ 1.

<sup>91</sup> Mark Pilling & Richard Pinkham, *Flight-Support; Regional Governments and Airports Have Gone to Great Lengths to Attract New Air Service in Europe—But Have They Gone Too Far?*, AIRLINE BUS., Oct. 1, 2003, at 63, 63-64.

<sup>92</sup> Stevie Fenner, *Airports Can Be Low Cost Too*, AIRLINE BUS., Dec. 1998, at 11, 11.

<sup>93</sup> Pilling & Pinkham, *supra* note 91, at 64.

<sup>94</sup> *2005 Guidelines*, *supra* note 10, ¶¶ 57, 74.

## 2. *The Ryanair Decision*

In 2002, the European Commission began investigating a complaint against Ryanair and Brussels South Charleroi Airport (“BSCA”). The complaint was based on benefits given to Ryanair by the Walloon Region, owner of the Charleroi airport infrastructure, and BSCA, a public sector company that manages the airport and is controlled by the Walloon Region.<sup>95</sup> In 2004, the Commission ruled that certain benefits received by Ryanair from BSCA and the Walloon Region were impermissible state aid.<sup>96</sup>

### a. *Setting the Scene*

Brussels South Charleroi Airport has run the Charleroi airport since 1991 under a fifty-year concession agreement.<sup>97</sup> Under its agreement with the Walloon Region, BSCA has the authority to collect sixty-five percent of airport taxes, the taxes paid by the businesses at the airport, the revenue from ground handling, the revenue from the sale of fuel, and fees from other services provided to airport users.<sup>98</sup> At the turn of the century, BSCA was struggling to turn a profit and had no regular carriers.<sup>99</sup>

In 2000, BSCA was locked in a three-way battle to become Ryanair’s first mainland European base.<sup>100</sup> On November 6, 2001, Ryanair, the Region of Walloon, and BSCA reached an agreement.<sup>101</sup> The region granted Ryanair a reduction in landing fees of approximately fifty percent of the amount fixed and published by the government.<sup>102</sup> BSCA agreed to pay a share of Ryanair’s expenses associated with operations at Charleroi and fixed ground handling services for Ryanair at ten percent of the price publicized by BSCA for other users.<sup>103</sup> In addition to these benefits, Ryanair and BSCA formed and contributed equally to a

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<sup>95</sup> *Ryanair Decision*, *supra* note 12, ¶ 12.

<sup>96</sup> The Ryanair decision and the Commission’s 2005 Guidelines, which are discussed later, rely on Article 86(2) and Article 87(3) of the EC Treaty, rather than Article 92 of the Treaty of Rome. The provisions of Article 87 of the EC Treaty are substantially the same as Article 92 of the Treaty of Rome.

<sup>97</sup> *Ryanair Decision*, *supra* note 12, ¶ 163.

<sup>98</sup> *Id.*

<sup>99</sup> Mark Pilling, *EC Investigates Ryanair/Charleroi Deal*, AIRLINE BUS., Jan. 1, 2003, at 18, 18.

<sup>100</sup> *Id.*

<sup>101</sup> *Ryanair Decision*, *supra* note 12, ¶ 11.

<sup>102</sup> *Id.*

<sup>103</sup> *Id.* ¶ 10.

joint advertising and publicity company created to finance publicity and marketing for Ryanair's Charleroi operations.<sup>104</sup> In exchange for these concessions, Ryanair agreed to base between two and four aircraft at Charleroi and to operate at least three rotations per aircraft over a fifteen-year period.<sup>105</sup> By 2003, Ryanair served twelve destinations from Charleroi,<sup>106</sup> and the airport handled more than 2.5 million Ryanair passengers.<sup>107</sup>

Shortly after Ryanair agreed to set up a base at Charleroi, the European Commission received a complaint from rival low-cost carrier Virgin Express, which is based at Brussels Zaventem airport.<sup>108</sup> In December 2002, the Commission initiated an investigation of Ryanair's agreement with Brussels South Charleroi to determine if benefits given to Ryanair by the Walloon Region and BSCA were impermissible state aid.<sup>109</sup>

#### b. Ryanair and Charleroi's Position

The thrust of the argument advanced by Ryanair and Charleroi was that the agreement between the companies complied with the principle of the private investor in a market economy.<sup>110</sup> In support of its argument, Ryanair noted that it had received more favorable conditions from privately owned airports<sup>111</sup> and that the fifteen-year duration of the agreements is not unusual, noting that it had agreements lasting ten to twenty years with most of the airports it uses.<sup>112</sup> Both Ryanair and Belgium pointed out that secondary airports are not sustainable until a critical mass of passenger traffic is obtained<sup>113</sup> and that secondary airports are often willing to endure losses for several years to ensure long-term profitability.<sup>114</sup>

Ryanair and Belgium also offered evidence showing that the deal had exceeded the parties' expectations. In arguing that the principal of a private investor in a market economy was satisfied by the deals, Ryanair noted that the volume of traffic at Charleroi had increased by 1,455 percent since Ryanair set up at Char-

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<sup>104</sup> *Id.* ¶ 11.

<sup>105</sup> *Id.*

<sup>106</sup> *Id.*

<sup>107</sup> Colin Baker, *Playing by the Rules*, AIRLINE BUS., Mar. 1, 2004, at 30.

<sup>108</sup> *Id.*

<sup>109</sup> Pilling & Pinkham, *supra* note 91, at 64.

<sup>110</sup> *See generally Ryanair Decision*, *supra* note 12, §§ 3 & 4.

<sup>111</sup> *Id.* ¶ 51.

<sup>112</sup> *Id.* ¶ 53.

<sup>113</sup> *See id.* ¶¶ 47, 83.

<sup>114</sup> *Id.* ¶ 62.

leroi.<sup>115</sup> Ryanair also noted that the value of the Charleroi airport had increased considerably since it began flying to Charleroi, pointing out the interest shown by private investors in purchasing twenty-five percent of BSCA.<sup>116</sup> Despite evidence that Ryanair had similar deals with private airports and that the parties' expectations had been exceeded, the European Commission was unwilling to bless the Ryanair/Charleroi deal.

c. The Commission's Findings

On February 12, 2004, the European Commission released its decision concerning aid granted by the Walloon Region and Brussels South Charleroi Airport to Ryanair.<sup>117</sup> The Commission determined that because BSCA is controlled by the Walloon Region through shareholding and bylaws and BSCA's revenue was controlled by airport taxes fixed by the region, aid granted to Ryanair by BSCA constituted state aid.<sup>118</sup> The Commission took the position that aid in the form of reduced in landing charges beyond the amounts published by the Walloon Region was incompatible with the common market.<sup>119</sup> The Commission also found that discounts on ground handling services given to Ryanair by BSCA were impermissible and stated that the total aid to be recovered should be determined by calculating the difference between BSCA's operating costs for ground handling services provided to Ryanair and the price invoiced to Ryanair.<sup>120</sup> Finally, the Commission determined that the remaining aid granted, by BSCA to Ryanair, including marketing contributions, one-shot incentives, and provisions of office space, were compatible so long as certain conditions were met.<sup>121</sup>

i. *Application of the Private Investor Test*

To determine whether the benefits given to Ryanair were permissible, the Commission first applied the private investor test.

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<sup>115</sup> *Id.* ¶ 49.

<sup>116</sup> *Id.* ¶ 55.

<sup>117</sup> See *Ryanair Decision*, *supra* note 12.

<sup>118</sup> *Id.* ¶ 158.

<sup>119</sup> *Id.* ¶ 357, art. 1.

<sup>120</sup> *Id.* ¶ 357, art. 2.

<sup>121</sup> *Id.* ¶ 357, art. 4. See Conditions for Aid, *infra* pp. 129-31, for a discussion of the conditions that must be satisfied before aid that does not satisfy the private investor may be declared compatible by the Commission under the Ryanair decision.

The Commission determined that BSCA's business plan did not conform to the private investor principal and that the aid was incompatible with Article 87(1) of the Treaty.<sup>122</sup> Among the exceptions the Commission took to the BSCA business plan was BSCA's reliance on substantial revenue from hypothetical carriers that would begin flying to Charleroi in the future.<sup>123</sup> The Commission also found that BSCA's reliance on subsidies that the region had not guaranteed was not in accord with the market economy investor principal.<sup>124</sup> After determining that BSCA's business plan did not conform to the market economy investor principal, the Commission addressed whether the aid fell within the exceptions created by Article 87(2) and 87(3) of the Treaty.

*ii. Exceptions Under Article 87(3)*

The Commission determined that Article 87(2) of the Treaty did not apply to the benefits given to Ryanair because "the aid in question is not of a social nature, nor is it intended to make good any damage caused by natural disasters or other exceptional events."<sup>125</sup> However, the Commission found that Article 87(3)(a) and (c) did apply because the "aid granted to Ryanair could have a regional socio-economic impact in Wallonia. . .," but the Commission held that the aid was "not in line with the rules that the Commission has. . . been applying for several years."<sup>126</sup> Rather than declaring the entire aid package given to Ryanair impermissible, the Commission laid out certain conditions that must be met for aid to be compatible with Article 87.

*d. Conditions for Aid*

The first set of conditions for aid granted by publicly owned airports to airlines relates to contributions made by the airport for opening a new route.<sup>127</sup> The Commission held that these contributions must be limited in time, and that time period must not exceed five years.<sup>128</sup> The Commission went on to state that the aim of the development plan should be the viability of the route after five years, and that the airport authority shall

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<sup>122</sup> *Id.* ¶ 184.

<sup>123</sup> *Id.* ¶ 192.

<sup>124</sup> *Id.* ¶ 219.

<sup>125</sup> *Id.* ¶ 252.

<sup>126</sup> *Id.* ¶ 255.

<sup>127</sup> *Id.* ¶ 357.

<sup>128</sup> *Id.* ¶ 357, art. 4.

validate start-up costs a posteriori.<sup>129</sup> Regarding the amount of aid a publicly owned airport may grant an airline, the Commission held that the total aid for the opening of a new route must not exceed fifty percent of the actual costs for that destination,<sup>130</sup> and contributions from a publicly owned airport must be “proportional and incentive in nature.”<sup>131</sup>

In addition to the provisions relating to the duration and the amount of aid a publicly owned airport may grant an airline, the Commission laid out several other conditions that must be satisfied when a publicly owned airport gives benefits to an airline. The Commission held that publicly owned airports cannot contribute to the opening of a new route opened as a replacement for a route closed by an airline at the airport or another airport “in the same economic or population catchment area.”<sup>132</sup> The Commission also discussed marketing contributions granted by publicly owned airports, holding that marketing contributions must be “justified in a development plan” and “validated . . . for each route concerned.”<sup>133</sup>

In the case of Ryanair and Charleroi, the Commission required that at the end of the five year start-up period, any contributions paid by BSCA to Ryanair that exceed the criteria described in the decision shall be recovered by Belgium.<sup>134</sup>

#### e. Implications of the Ryanair Decision

For the most part, the Commission’s approach to the Ryanair decision was consistent with the approach laid down by the 1994 Guidelines for determining whether state aid is permissible. First the commission applies the private investor in a market economy test. Then, if it is determined that the public authority did not act in accordance with a private investor in a market economy, the commission determines whether the aid meets one of the 87(3) exceptions. The Commission’s decision provides insight into several state aid principals. The decision sheds light on how the European Commission will apply the private investor test and explains the circumstances in which start-up aid may be provided at state-controlled regional airports.

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<sup>129</sup> *Id.*

<sup>130</sup> *Id.*

<sup>131</sup> *Id.*

<sup>132</sup> *Id.*

<sup>133</sup> *Id.*

<sup>134</sup> *Id.*

*i. Application of the Private Investor Test*

In reaching its conclusion that BSCA had entered into an agreement that no reasonably informed private investor would enter into, the Commission provided a blueprint of how it would apply the private investor test in cases involving start-up aid from state-owned regional airports. The Commission's decision makes clear that when determining whether or not a state-owned regional airport behaved as a private investor in a market economy, it will only consider the operational parameters of the airport offering incentives.<sup>135</sup> Deals between the airline receiving incentives and other airports will not be considered.<sup>136</sup> Thus, Ryanair's arguments that similar agreements were made with privately owned airports fell on deaf ears.<sup>137</sup>

The Ryanair decision also clarifies the time perspective from which the private investor test should be applied. According to the Commission, the proper application of the private investor test is from the time when the financial support measures were taken.<sup>138</sup> In other words, to determine "whether the [airport] has acted like a prudent private investor in a market economy, it will be necessary, in accordance with court case law, to place oneself back in the context of the period during which the financial support measures were taken."<sup>139</sup> So even though Ryanair and Belgium were able to show that the benefits flowing from the relationship were positive and that the investment had a higher return than originally expected, the Commission determined that the deal between Ryanair and BSCA fell within the meaning of Article 87(1) of the EC Treaty.<sup>140</sup>

The Commission's decision to determine whether BSCA acted as a private investor prospectively, that is, viewing the deal objectively from the time it was signed, rather than retrospectively, taking into account developments since the deal was entered, appears unreasonable. After all, there is a strong argument that a deal that, in reality, has proven profitable within a reasonable amount of time and has surpassed the parties' expectations was in fact reasonable at the time the deal was made. However, because the Commission cannot truly discover

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<sup>135</sup> *Id.* ¶ 171.

<sup>136</sup> *Id.*

<sup>137</sup> *Id.*

<sup>138</sup> *Id.* ¶ 178.

<sup>139</sup> *Id.*

<sup>140</sup> *Id.* ¶ 238.

what was going through the minds of the parties when the deal was made, it makes sense from an enforcement point of view to evaluate contracts objectively from the time the agreement was reached. This approach also encourages airlines and publicly owned airports to examine their deals more thoroughly and avoid unknowns in their business models before moving forward with a particular agreement.

*ii. When a State May Provide Incentives*

The Ryanair decision also addresses when benefits granted to an airline that do not satisfy the private investor test satisfy Article 87(3) of the EC Treaty. Article 87(3) defines certain situations in which state aid may be considered acceptable.<sup>141</sup> The treaty provides:

The following may be considered to be compatible with the common market:

- (a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment;
- (b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;
- (c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest;
- (d) aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Community to an extent that is contrary to the common interest;
- (e) such other categories of aid as may be specified by decision of the Council acting by a qualified majority on a proposal from the Commission.<sup>142</sup>

The Commission determined that the incentives the Region and BSCA provided Ryanair fell under points (a) and (c) of Article 87(3).<sup>143</sup> However, the Commission, balancing competing interests of regional development and an open market, provided cer-

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<sup>141</sup> Treaty Establishing the European Community (Nice Consolidated Version), Dec. 24, 2002, 2002 OJ (C 325) 211 [hereinafter EC Treaty].

<sup>142</sup> *Id.* art. 87(3).

<sup>143</sup> *Ryanair Decision*, *supra* note 12, ¶ 254.



tain criteria and limitations for aid falling within the bounds of Article 87(3).<sup>144</sup>

In the wake of the Ryanair decision, the European Commission [EC] began preparing guidelines on the use of state funds to finance airport infrastructure and start-up aid for new routes. The EC's goals in drafting the guidelines were "to 'reconcile the objectives of regional development and of fair competition' and 'bring more transparency' to the regulations."<sup>145</sup>

### 3. *The 2005 Guidelines*

The Commission's 2005 Guidelines were drafted with several underlying factors in mind. The Commission realized that small airports often do not have the passenger volume to reach the break even point<sup>146</sup> and that airlines may be unwilling to open new routes from unknown and untested airports without incentives to reduce their risk.<sup>147</sup> In light of this, the Commission recognized that the aims of the EC Treaty, particularly economic, social cohesion, and the balanced development of the regions, can be furthered in certain instances by allowing certain state aid exceptions.

#### a. *Introduction*

The Commission traditionally viewed airports as pieces of infrastructure serving different markets, but the growth of low-cost carriers and the increasing competition between secondary airports for low-cost business forced the Commission to change its view.<sup>148</sup> Airports are now viewed as market players competing for carriers' business. Nearly two years after the Ryanair decision, in December 2005, the European Commission released guidelines on the financing of airports and start-up aid to airlines departing from regional airports.<sup>149</sup> The 2005 Guidelines recognize that the creation of a single European airspace is a work in progress and that the 1994 Guidelines do not cover new developments in airport financing and start-up aid for new routes.<sup>150</sup> In particular, the 2005 Guidelines recognize the

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<sup>144</sup> See *infra* § III(B)(2)(b).

<sup>145</sup> David Kaminski-Morrow, *EC Proposes State-Aid Limits for New Regional Airport Routes*, AIR TRANSP. INTELLIGENCE, Feb. 8, 2005.

<sup>146</sup> *Ryanair Decision*, *supra* note 12, ¶ 71.

<sup>147</sup> *Id.* ¶ 72.

<sup>148</sup> Baker, *supra* note 107, at 30.

<sup>149</sup> See generally *2005 Guidelines*, *supra* note 10.

<sup>150</sup> *Id.* ¶ 17.

emergence of low-cost carriers and the “drive by airports in recent years to secure new air links.”<sup>151</sup> The 2005 Guidelines focus on financing airports and start-up aid for new routes.<sup>152</sup> Because this Comment is concerned with the impact of the European Commission’s state aid policy on low-cost carriers, my discussion of the 2005 Guidelines will focus on those provisions that seem to most impact low-cost carriers.

Like earlier guidelines and previous Commission and Court of Justice decisions addressing state aid, the thrust of the 2005 Guidelines is the principle of a private investor in a market economy. The 2005 Guidelines provide that the Commission will determine whether public funding benefiting airports or airlines constitutes illegal aid by considering “whether ‘in similar circumstances a private shareholder, having regard to the foreseeability of obtaining a return and leaving aside all social, regional-policy and sectoral considerations, would have subscribed the capital in question,’”<sup>153</sup> In other words, if an airport or airline receives financing or benefits from public resources under terms more favorable than normally would be available from a private economic operator, that airport or airline is receiving impermissible state aid.

#### b. Airport Financing

The 2005 Guidelines contain important provisions relating to benefits and funds granted to publicly owned airports by the states that own them. The guidelines group airport activities into four groups and address benefits and aid granted to airports based on the category into which the aid is directed. The 2005 Guidelines categorize airport activities as follows:

- (i) construction of airport infrastructure and equipment (runways, terminals, aprons, control tower) or facilities that directly support them (fire-fighting facilities, security or safety equipment);
- (ii) operation of the infrastructure, comprising the maintenance and management of airport infrastructure;
- (iii) provision of airport services ancillary to air transport, such as groundhandling services and the use of related infrastructure, fire-fighting services, emergency services, security services, etc; and

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<sup>151</sup> *Id.* ¶ 5.

<sup>152</sup> See generally 2005 Guidelines, *supra* note 10.

<sup>153</sup> *Id.* ¶ 46.

(iv) pursuit of commercial activities not directly linked to the airport's core activities, including the construction, financing, use and renting of land and buildings, not only for offices and storage but also for the hotels and industrial enterprises located within the airport, as well as shops, restaurants and car parks.<sup>154</sup>

The guidelines apply to "all airport activities, with the exception of safety, air traffic control and any other activities for which a Member State is responsible as part of its official powers as a public authority;" the aforementioned category (iv), "pursuit of commercial activities not directly linked to the airport's core activities," also falls outside the scope of the 2005 Guidelines.<sup>155</sup>

In its discussion of airport financing, the 2005 Guidelines first address state financing of airport infrastructure, category (i). The guidelines provide that any airport operator engaged in an "economic activity" should "finance the costs of using or building the infrastructure it manages from its own resources."<sup>156</sup> Therefore, the provision of airport infrastructure or public resources to help finance airport infrastructure to an airport operator by a Member State must be in accordance with the principle of a private investor in a market economy.<sup>157</sup> Benefits that fail to satisfy the private investor test constitute state aid unless the Commission determines the aid satisfies the exceptions articulated by Articles 87(3)(a), (b), or (c) or Article 86(2) of the Treaty.<sup>158</sup>

Next, the 2005 Guidelines address aid for the operation of airport infrastructure, category (ii), and provide that airport operators "should meet the normal costs of running and maintaining airport infrastructure from its own resources."<sup>159</sup> However, the Commission creates exceptions for operating subsidies "on the basis of Articles 87(3)(a) or (c), under certain conditions, in disadvantaged regions, or on the basis of Article 86(2) if it meets certain conditions. . . ."<sup>160</sup>

In addressing aid for airport services ancillary to air transport, category (iii), the 2005 Guideline's note that groundhandling services at airports serving over two million passengers annually are a commercial activity open to competition pursuant to Di-

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<sup>154</sup> *Id.* ¶ 53.

<sup>155</sup> *Id.* ¶¶ 53, 54.

<sup>156</sup> *Id.* ¶ 57.

<sup>157</sup> *Id.*

<sup>158</sup> *Id.*

<sup>159</sup> *Id.* ¶ 62.

<sup>160</sup> *Id.* ¶ 63.

rective 96/67/EC.<sup>161</sup> The guidelines require that “ground-handling services must be self-financing and must not be cross-subsidized by the airport’s other commercial revenue or by public resources granted to it as airport authority or operator of a service of general economic interest” when an airport serves more than two million passengers annually.<sup>162</sup> On the other hand, the guidelines allow airports that serve fewer than two million passengers annually to offset groundhandling losses with revenue from other commercial activities.<sup>163</sup> Presumably, other ancillary services are handled similarly.

c. Start-Up Aid

The Commission, responding to the outcry following the Ryanair decision, published guidelines for determining when aid that does not satisfy the private investor test, thus failing to comply with Article 87(1) of the Treaty, falls within the provision of Article 87(3). The 2005 Guidelines list a number of conditions which must be met before the Commission will approve start-up aid that does not comply with the private investor test.

i. Parties

The 2005 Guidelines strictly limit who may benefit from and grant start-up aid. The Commission requires that only carriers with a valid operating license issued by a Member State according to Council Regulation (EEC) No 2407/92 may receive aid.<sup>164</sup> The next requirement relates to the size of the airport the new route will service. Airports may only grant aid where the route links a category C airport, a “large regional airport” with an annual passenger volume between one and five million, or category D airport, a “small regional airport” with an annual passenger volume of less than one million, to another EU airport.<sup>165</sup> However, the Commission states that exceptions might be made when aid is granted for routes between airports having an annual passenger volume of five to ten million, when one of the airports served is located in a disadvantaged region or when a route serves an airport located in an outermost region.<sup>166</sup>

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<sup>161</sup> *Id.* ¶ 68.

<sup>162</sup> *Id.* ¶ 70.

<sup>163</sup> *Id.* ¶ 69.

<sup>164</sup> *Id.* ¶ 79(a).

<sup>165</sup> *Id.* ¶ (79)(b).

<sup>166</sup> *Id.*

*ii. New Routes*

The guidelines also limit what routes may receive aid. Before offering aid, the public body offering the start-up aid must “carry out an analysis of the impact of the new route on competing routes prior to granting start-up aid.”<sup>167</sup> The 2005 Guidelines require that aid will only be allowed when the opening of a new route will lead to an increase in the net volume of passengers to an airport.<sup>168</sup> The guidelines also state that “start-up aid must not be paid when the new air route is already being operated by a high-speed rail service under the same criteria.”<sup>169</sup> In addition, the 2005 Guidelines require that airlines provide a business plan showing the long-term viability of a new route when the airline proposes service to a public body offering to grant start-up aid for the opening of the new route.<sup>170</sup>

*iii. Long-Term Viability and Degressiveness*

The guidelines require that the route receiving aid ultimately prove profitable.<sup>171</sup> To ensure that public resources are not drained by unprofitable routes, the Commission requires start-up aid to be degressive and limited in duration.<sup>172</sup> The Commission also requires that the amount of aid granted be linked to the number of passengers transported.<sup>173</sup> As the number of passengers on the route increases and the route approaches the break even point, the amount of aid must decrease.<sup>174</sup> In most instances, “degressive aid may be granted for a maximum period of three years.”<sup>175</sup> However, the guidelines further limit the duration of start-up aid requiring that “the aid should be stopped once the objectives in terms of passengers have been reached or when the line breaks even, even if this is achieved before the end of the period initially foreseen.”<sup>176</sup> The guidelines also limit the amount of aid, referred to as “intensity,” that an airline may receive for new routes in a given year.<sup>177</sup> In most cases,<sup>178</sup> aid

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<sup>167</sup> *Id.* ¶ 78(1).

<sup>168</sup> *Id.* ¶ 79(c).

<sup>169</sup> *Id.*

<sup>170</sup> *Id.* ¶ 79(i).

<sup>171</sup> *Id.* ¶ 78(d).

<sup>172</sup> *Id.*

<sup>173</sup> *Id.* ¶ (79)(g).

<sup>174</sup> *Id.*

<sup>175</sup> *Id.* ¶ 78(f).

<sup>176</sup> *Id.*

<sup>177</sup> *Id.*

may not exceed fifty percent of eligible costs (marketing, advertising, etc.) for a given year, and the total amount of aid may not exceed thirty percent of eligible costs.<sup>179</sup>

*iv. Compensation for Additional Start-up Costs*

The 2005 Guidelines also limit the operations that aid may fund, requiring that the amount of aid be “strictly linked to the additional start-up costs incurred in launching the new route . . . which the air operator will not have to bear once it is up and running”—costs like marketing and advertising or installation costs.<sup>180</sup> The Commission specifically states that aid cannot be granted for standard operating costs.<sup>181</sup>

*v. Non-Discriminatory Allocation and Publicity*

The 2005 Guidelines insist that “any public body which plans to grant start-up aid to an airline for a new route . . . must make its plans public in good time and with adequate publicity to enable all interested airlines to offer their services.”<sup>182</sup> To ensure that the market is not distorted by aid, the Commission requires states to “ensure that the list of routes receiving aid is published annually for each airport, in each instance indicating the source of public funding, the recipient company, the amount of aid paid and the number of passengers concerned.”<sup>183</sup>

*4. The Impact of Ryanair and the New Guidelines on Low-Cost Carriers and Publicly Owned Secondary Airports*

Although the 2005 Guidelines purport to adopt “a neutral stance on the question of whether a State opts for public or private ownership of airports,”<sup>184</sup> the guidelines offer a significant competitive advantage to privately owned secondary airports. While there is no way to know what effect the 2005 Guidelines will actually have, low-cost carriers and regional airports are worried that the new guidelines will adversely affect their businesses and “that without the ability to strike aggressive deals many

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<sup>178</sup> Routes from disadvantaged regions and sparsely populated regions are subject to slightly different intensity and duration limits. See *id.* ¶ 79(f).

<sup>179</sup> *Id.*

<sup>180</sup> *Id.* ¶ 78(e).

<sup>181</sup> *Id.*

<sup>182</sup> *Id.* ¶ 79(h).

<sup>183</sup> *Id.* ¶ 79(j).

<sup>184</sup> *Id.* ¶ 30.

routes will not be started.”<sup>185</sup> Likewise, regional governments are concerned that regional development may be hindered by the inability of regional airports to open new routes.<sup>186</sup>

The 2005 Guidelines create bright line boundaries limiting the amount of state funded incentives an airport can offer an airline. In effect, the Commission in the 2005 Guidelines has made a blanket ruling on all future aid cases regardless of the airport and region’s individual situation or the individual facts of a case. Unless a publicly owned regional airport’s start-up aid package falls within the limits of the 2005 Guidelines, regardless of the benefits to the region or the individual circumstances surrounding the deal, publicly owned regional airports will be unable to go forward with their offer. This puts publicly owned, regional airports at a significant disadvantage to privately owned airports, which are not limited by the 1994 or 2005 Guidelines on state aid.

a. Arbitrary Limitations on the Size of Airports that May Offer Aid

The guidelines approve start-up aid only at airports serving fewer than five million passengers annually. Limiting aid to airports serving five million passengers per year is an arbitrary exception to the principal of the market investor in a private economy. By limiting the availability of aid, the Commission ignores factors such as the size of existing airport infrastructure, the utilization of existing airport infrastructure, and other factors contributing to the critical mass necessary for a given airport to attain profitability. A more sensible approach to determining whether an airport may grant start-up aid would be to examine the individual characteristics of the airport and determine whether state aid might be necessary to reach that airport’s critical mass.

b. Publicly Owned Airports’ Ability to Strike Deals

Provisions relating to the intensity and duration of aid also put publicly owned secondary airports at a disadvantage. A privately owned airport well-versed in the guidelines would likely be willing to offer incentives just outside of the boundary created by the guidelines to lure an airline to its airport.

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<sup>185</sup> Mark Pilling, *Concern Mounts Over Airport Aid Rules*, AIRLINE BUS., Feb. 1, 2005, at 19.

<sup>186</sup> *Id.*

Although it may make sense from an enforcement point of view to create bright line boundaries within which publicly owned airports must operate, strict boundaries like the 2005 Guidelines relating to start-up aid give privately owned airports a competitive advantage. Not only do the 2005 Guidelines give privately owned airports a negotiating advantage in terms of flexibility, but they also provide an advantage in terms of information. The transparency that the guidelines require and the limitations placed on publicly owned airports give privately owned airports tremendous leverage and bargaining power. Ironically, the 2005 Guidelines that aim to rid the market of distortion in fact distort the market by giving privately owned airports leverage and information that would be unavailable in an undistorted market.

c. Poaching by Private Airports

The guidelines allowing aid “only to the opening of new routes . . . which will lead to an increase in the net volume of passengers,” in particular those provisions that prohibit aid which encourages “relocation of traffic which is unjustified with regard to the frequency and viability of existing services leaving from another airport in the same city, the same conurbation or the same airport system which serve the same or a similar destination under the same criteria,”<sup>187</sup> leave publicly owned secondary airports open to poaching by privately owned airports serving the same area. A publicly owned airport limited by state aid regulations may lack the financial flexibility to prevent a privately owned airport from luring a carrier away from the publicly owned airport. Then, after the carrier has been lured away, the publicly owned airport will be unable to reestablish the route with another carrier because of the “increase in net volume” limitations. While this situation is unlikely to arise between two airports located in the same nation, it is conceivable that a public and private airport that are both located in the same region but across the border from each other might engage in competition for the same airline’s business.

d. Improvements to Existing Air Services

The provisions of the 2005 Guidelines that limit start-up aid to “new routes or new schedules . . . which will lead to an increase

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<sup>187</sup> 2005 Guidelines, *supra* note 10, ¶ 79(c).



in the net volume of passengers”<sup>188</sup> might limit a region’s ability to improve existing air services. For example, a region hoping to expand service at a regional airport may be unable to finance airport expansions that would allow the airport to upgrade from propeller service to jet service due to the 2005 Guidelines’ restrictions.

e. Favoritism of Rail

The 2005 Guidelines also favor high-speed rail alternatives over the establishment of new air routes.<sup>189</sup> While this favoritism is noble, particularly since high-speed rail has received heavy public funding,<sup>190</sup> a strong argument can be made that favoring the rail industry over establishing new air routes mocks market liberalization. Now, rather than allowing low-cost carriers to tap new markets, which would give consumers the option for low-cost, rapid, point-to-point air travel, the 2005 Guidelines’ provisions prohibiting start-up aid in regions with access to high-speed rail limits the ability of low-cost carriers to open new routes.

f. Increased Litigation

The Commission’s decision to involve itself in aid to airports and start-up aid to low-cost carriers puts publicly owned airports and low-cost carriers that enter into deals with publicly owned regional airports at a significant risk of litigation stemming from complaints by rival airlines and privately owned airports. The potential for litigation may have a chilling effect, encouraging low-cost carriers to seek deals with similarly situated privately owned airports rather than with publicly owned airports.

The impact of the advantages offered by the new guidelines may be blunted by the fact that “[m]ost small airports in the EU are still owned and operated by public authorities in the public interest,”<sup>191</sup> but the fact remains that the 2005 Guidelines create a substantial advantage for privately owned secondary airports. This, in turn, limits the flexibility and savings available to low-cost carriers when establishing new routes. While the 2005 Guidelines may significantly affect the abilities of low-cost carri-

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<sup>188</sup> *Id.*

<sup>189</sup> *See id.* (stating “start-up aid must not be paid when the new air route is already being operated by high-speed rail service under the same criteria”).

<sup>190</sup> Kaminski-Morrow, *supra* note 145, at 19.

<sup>191</sup> 2005 Guidelines, *supra* note 10, ¶ 8.

ers and publicly owned regional airports, there are no guarantees that these effects will materialize. Ryanair has appealed the EC's 2004 decision to the European Court of Justice, and the outcome may force the EC to revise the guidelines. But as they stand, the 2005 Guidelines substantially hinder the competitiveness of regional airports and limit the options available to low-cost carriers.

#### IV. CONCLUSION

The European air transport sector has seen significant change in the first decade post-liberalization. The expansion of low-cost carriers across the intra-Community market promises to bring lower fares, greater choice to consumers, increased efficiency in the air transport sector, and a more reliable network. However, the entry of the low-cost carrier into the intra-Community market, which was made possible by European Commission's 1994 Guidelines on state aid in the aviation sector, will likely be hindered by the Commission's most recent guidelines relating to the financing of airports and start-up aid to airlines departing from regional airports.

The Commission's one-size-fits-all approach to airport financing and start-up aid leaves publicly owned airports without the flexibility to compete with privately owned airports. As a result, low-cost carriers have diminished bargaining power, and their ability to strike aggressive deals is hindered. Conceptually, this might lead to higher operating costs, which would then be passed on to the consumer, leading to higher ticket prices and less demand for low-cost services. The Commission's approach also undercuts the States' ability to foster regional development and the development of low-cost air travel.

A more sensible approach to determining whether aid and benefits constitute impermissible aid is to consider each case individually. While this may lead to greater administrative oversight and bureaucratic delays, a system can be implemented to streamline the process.

One possible solution is to set up a system for approval of aid prior to the finalization of a deal between a publicly owned airport and an airline. This would involve the creation of a system for notice and approval of proposed aid packages. In determining whether an aid package falls within Article 87(3), the Commission should examine the existing infrastructure, the utilization of existing infrastructure, and the unique situation of the region served by the airport offering aid, basing its decision

on the individual facts underlying each agreement rather than on arbitrary guidelines. The procedure might include an opportunity for the parties to be heard, as well as some sort of appeal procedure. The potential for bureaucratic disaster is great, but an efficient, streamlined procedure is possible.

Despite the Commission's 2005 Guidelines and the Ryanair decision, the dispute over benefits given to airlines by publicly owned airports is far from over. Ryanair has appealed the Commission's 2004 decision, and subject to the Court of Justice's ruling, the Commission's position with respect to start-up aid for airlines may change. For the time being, however, the Commission's stance on state aid seems to put publicly owned airports and low-cost carriers who are dependant on secondary airports to keep costs low at a significant disadvantage in the air transport market, tipping the playing field in favor of privately owned airports and large well-established carriers. The full impact of the 2005 Guidelines on low-cost carriers has yet to be seen, but as they stand, the guidelines threaten the rapid growth that low-cost carriers have enjoyed in the European Union over the past decade.